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FM AMEMBASSY CARACAS
TO RUEHC/SECSTATE WASHDC 7327
INFO RUEHAC/AMEMBASSY ASUNCION 0743
RUEHBO/AMEMBASSY BOGOTA 7167
RUEHBR/AMEMBASSY BRASILIA 5842
RUEHBU/AMEMBASSY BUENOS AIRES 1535
RUEHLP/AMEMBASSY LA PAZ 2429
RUEHPE/AMEMBASSY LIMA 0684
RUEHMN/AMEMBASSY MONTEVIDEO 0891
RUEHQT/AMEMBASSY QUITO 2519
RUEHSG/AMEMBASSY SANTIAGO 3846
RUEHAO/AMCONSUL CURACAO 1089
RUEHGL/AMCONSUL GUAYAQUIL 0731
RUEATRS/DEPT OF TREASURY
RHEHNSC/NSC WASHDC
RUEHRC/DEPT OF AGRICULTURE USD FAS
RUCPDOC/DEPT OF COMMERCE

UNCLAS SECTION 01 OF 02 CARACAS 003653

SIPDIS

SENSITIVE
SIPDIS

TREASURY FOR KLINGENSMITH AND NGRANT
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD

E.O. 12958: N/A
TAGS: ECON EFIN VE
SUBJECT: VENEZUELA: THE BEST IS YET TO COME

¶1. (SBU) SUMMARY: Two days after the Presidential election, the BRV instituted several changes to customs and currency control regulations. The measures included a 15 percent luxury tariff, price controls on construction materials, and changes to the list of goods which qualify for foreign exchange. Taken as a whole, these changes which were published in the Official Gazette, portend even greater BRV intervention in the economy and a likely move towards Prebisch style Import Substitution Industrialization policies. END SUMMARY.

¶2. (U) On December 5, the Ministry of Light Industries and Commerce (MILCO) announced a new 15 percent tariff surcharge on luxury goods and those considered "non-priority items." Included among the 200-plus items are: alcohol (including Venezuelans beloved whiskey), rugs and carpeting, furniture, jewelry, and toilet paper. This new tax raises the tariff on most of these goods to 35 percent, which along with the 14 percent value added tax brings the government's take on these sales to over one third of their price. (Comment: One astute observer characterized this measure as "selective devaluation." End Comment.)

¶3. (U) The Commission for the Administration of Foreign Exchange (CADIVI) approves most foreign exchange transactions in Venezuela. For an ever-increasing list of goods, however, the requester must first get approval from the Ministry of Agriculture or MILCO to show that the good they are seeking to import is not produced in Venezuela, or that there is insufficient domestic production to meet demand. In addition to being another bureaucratic hurdle for private industry, this requirement allows the BRV to try to promote domestic production by restricting imports. The revised list now includes 3,500 items which do not require separate ministry approval to obtain dollars while a remaining 5,500 items still require this certificate of approval. The pre-approved list is increasingly geared towards primary inputs (minerals, chemicals, etc.) and capital goods (machinery) destined for

Venezuelan industry.

¶4. (U) In addition to increasing import taxes on "luxury" goods and speeding the approval process to obtain dollars to import goods for industry, the BRV also imposed price controls on 47 items used in construction, including: sand, stones, brick, steel rods, wire, wood, metal doors and frames. The construction sector is booming in Venezuela due to the oil-fueled economic boom and government policies. Banks are required to lend a minimum of 10 percent of their portfolios to construction, and the government has been funding new schools, homes and infrastructure projects around the country. Building material prices have gone up significantly this year and there are shortages of concrete and other materials throughout the country due to high demand and a disinclination by companies to invest to increase production. Fixing prices will only exacerbate the shortages by pricing the goods below their market rates and creating a black market where goods are sold at higher rates or with kickbacks. (Note: interestingly, and in an odd twist, Post heard that the BRV set the prices for some materials using the rate contractors charged municipalities which is way above the market rate. We cannot confirm this yet. End Note.)

¶5. (SBU) These changes portend an even heavier government hand in the market and a state paternalism reminiscent of the thoroughly discredited Prebisch style Import Substitution Industrialization (ISI) policies of the 1960s. By taxing imports and consumption of luxury and finished items while encouraging the importation of primary inputs and capital goods (via CADIVI approvals, directed lending and government support), the BRV seeks to create an industrial base neither

efficient nor necessarily appropriate for the Venezuelan economy.

¶6. (SBU) An over-valued exchange rate is also a tenet of ISI that makes capital goods cheaper, though in practice has hurt Venezuelan companies which cannot compete with artificially cheap imports. The increasing number of government policies to promote industrialization are occurring as thousands of industrial establishments close their doors. This irony appears to be lost on Chavez and BRV officials, who routinely decry Venezuela's lack of an industrial base while enthusiastically legislating the country's deindustrialization. If any lesson is to be drawn from policies of the last eight years it is that the industries most likely to have a leg up are those dependent on Chavez, by way of state ownership or subsidies, and those whose "politically correct" behavior keep them presidentially potable.

¶7. (SBU) COMMENT: These measures, taken only two days after the elections, offer a preview of 2007. While the government may expect its policies to incentivize domestic production, a host of other contradictions (including the over-valued exchange rate, rigid labor laws, currency controls, a lack of contract enforcement, a weak intellectual property rights regime, price controls, and a lack of predictable BRV attitude towards the private sector) make it more likely that inflation will accelerate as people pay more for their ever-dearer imported goods. Price controls -- already creating distortions throughout the economy -- are likely to make recurring shortages even worse. END COMMENT.

BROWNFIELD